# AN OVERVIEW OF STATE BOND DEBT ★ ★ ★

*Prepared by the Legislative Analyst's Office*

This section provides an overview of the state's current situation involving bond debt. It also discusses the impact that the bond measure on this ballot would, if approved, have on this debt level and the costs of paying such debt off over time.

## Background

***What Is Bond Financing?*** Bond financing is a type of long-term borrowing that the state uses to raise money for various purposes. The state obtains this money by selling bonds to investors. In exchange, it agrees to repay this money, with interest, according to a specified schedule.

***Why Are Bonds Used?*** The state has traditionally used bonds to finance major capital outlay projects such as roads, educational facilities, prisons, parks, water projects, and office buildings. This is done mainly because these facilities provide services over many years, their large dollar costs can be difficult to pay for all at once, and different taxpayers over time benefit from the facilities. Recently, however, the state has also used bond financing to help close major shortfalls in its General Fund budget.

***What Types of Bonds Does the State Sell?*** The state sells three major types of bonds. These are:

- ***General Fund-Supported Bonds.*** These are paid off from the state's General Fund, which is largely supported by tax revenues. These bonds take two forms. The majority are *general obligation* bonds. These must be approved by the voters and their repayment is guaranteed by the state's general taxing power. The second type is *lease-revenue* bonds. These are paid off from lease payments (primarily financed from the General Fund) by state agencies using the facilities they finance. These bonds do not require voter approval and are not guaranteed. As a result, they have somewhat higher interest costs than general obligation bonds.
- ***Traditional Revenue Bonds.*** These also finance capital projects but are not supported by the General Fund. Rather, they are paid off from a designated revenue stream—usually generated by the projects they finance—such as bridge tolls. These bonds also are not guaranteed by the state's general taxing power and do not require voter approval.
- ***Budget-Related Bonds.*** In March 2004, the voters approved Proposition 57, authorizing $15 billion in bonds to help pay off the state's accumulated budget deficit and other obligations. Of this amount, $11.3 billion was raised through bond sales in May and June of 2004, and $3.7 billion is available for later sales. The General Fund cost of repaying the principal and interest on these bonds is the equivalent of a one-quarter-cent share of the state sales tax (projected to be $1.4 billion in 2006–07). The bonds' repayments are also guaranteed by the state's general taxing power in the event the sales tax proceeds fall short.

***What Are the Direct Costs of Bond Financing?*** The state's cost for using bonds depends primarily on the amount sold, their interest rates, the time period over which they are repaid, and their maturity structure. For example, the most recently sold general obligation bonds will be paid off over a 30-year period with fairly level annual payments. Assuming that a bond issue carries a tax-exempt interest rate of 5 percent, the cost of paying them off with level payments over 30 years is close to $2 for each dollar borrowed—$1 for the amount borrowed and close to $1 for interest. This cost, however, is spread over the entire 30-year period, so the cost after adjusting for inflation is considerably less—about $1.30 for each $1 borrowed.

## The State's Current Debt Situation

***Amount of General Fund Debt.*** As of January 1, 2006, the state had about $44 billion of infrastructure-related General Fund bond debt outstanding on which it is making principal and interest payments. This consists of about $36 billion of general obligation bonds and $8 billion of lease-revenue bonds. In addition, the state has not yet sold about $32 billion of authorized general obligation and lease-revenue infrastructure bonds. This is either because the projects involved have not yet been started or those in progress have not yet reached their major construction phase. The above totals do not include the deficit-financing bonds identified above.

***General Fund Debt Payments.*** We estimate that General Fund debt payments for infrastructure-related general obligation and lease-revenue bonds will be about $3.8 billion in 2005–06. If previously authorized but currently unsold bonds are marketed, outstanding bond debt costs would rise to approximately $5.8 billion in 2010–11, and slowly decline thereafter if no new bonds are authorized. If, in addition, the annual costs of the deficit-financing bonds are included, total debt-service costs will be $5.1 billion in 2005–06, rising to a peak of $7.6 billion in 2010–11 before declining. These amounts would be higher if repayment of the deficit-financing bonds is accelerated using transfers from the Budget Stabilization Account that was established by Proposition 58 (approved in March 2004).

***Debt-Service Ratio.*** The level of General Fund debt service stated as a percentage of state revenues is referred to as the state's debt-service ratio (DSR). This ratio is used by many policymakers and members of the investment community as one indicator of the state's debt burden. The DSR increased in the early 1990s and peaked at 5.4 percent before falling back to below 3 percent in 2002–03, partly due to some deficit-refinancing activities. The DSR then rebounded beginning in 2003–04 and currently stands at 4.3 percent. It is expected to increase to a peak of 4.9 percent in 2009–10 as currently authorized bonds are sold off. If the annual debt service on the deficit-financing bonds is included, the ratio is currently at 5.7 percent, and will increase to a peak of 6.5 percent in 2009–10 before declining in subsequent years.

## Effects of the Bond Proposition on This Ballot

There is one bond measure on this ballot—Proposition 81, which would authorize the state to issue $600 million of general obligation bonds to finance library construction.

***Impacts on Debt Payments.*** If the $600 million in bonds on this ballot are approved and eventually sold at an interest rate of 5 percent, they would require total debt-service payments of $1.2 billion over their 30-year life, including $600 million for principal and $570 million for interest. The average annual payment would be about $40 million.

***Impact on the Debt-Service Ratio.*** Because of the state's large revenue base, the annual debt service on these bonds would only slightly increase the DSR.